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LATER DEVELOPMENTS IN THE UNION PACIFIC MERGER CASE

SUMMARY

First attempt to dissolve the combination of the Harriman lines, 772. — Opinion of the Supreme Court, 773. — Second unmerging plan, 774. — Difficulties encountered in separating the Southern Pacific from the Central Pacific, 775. — Attitude of the Pacific Coast, 778. — The State Railroad Commission of California refuses to approve proposed leases and other contracts in California, 785. — Modified version of the second unmerging plan, 786. — Third plan successful, 787. — Distribution of Baltimore and Ohio Stock, 789. — Final outcome of the proceedings, 790.

IN an article in this Journal for February, 1913, the writer discussed the decision of the Supreme Court in the Union Pacific Merger Case. Since that time there have been developments which justify mention. It will be recalled that the decree of the Supreme Court in the decision of December 2, 1912, called upon the Union Pacific to divest itself of the ownership of the Southern Pacific, altho it declared that nothing in the Court's instructions was to be construed as preventing the Union Pacific from retaining the Central Pacific property from Odgen to San Francisco. In response to this decision the Union Pacific immediately prepared to distribute its Southern Pacific holdings among its own individual stockholders. The action was in accordance with precedent in the Northern Securities, Standard Oil, and Powder cases, and there was some hope that it would be approved, in spite of the opposition of the Attorney-General.¹ As it turned out, the

¹ The Attorney-General desired that the shares be distributed among the holders of Southern Pacific stock as well as among holders of Union Pacific stock. Reporters'

hope was without foundation. When the matter was submitted to it in December, 1912, the Supreme Court curtly declared the plan inadmissible. "The ultimate determination of the affairs of a corporation," said the Court, "rests with its stockholders and arises from their power to choose the governing board of directors. After such distribution as is now proposed, the stockholders of the Union Pacific Company may dominate and control not only the Union Pacific Company but the Southern Pacific Company as well."

This decision made it necessary to revise the original project completely. At the same time the insistence of the Attorney-General that the Southern Pacific should dispose of the Central Pacific made it seem advisable to avoid further litigation by including a transfer of the Central Pacific Railway to the Union Pacific in the dissolution plan. The step was taken reluctantly. It appears that the question was referred to eminent counsel, and that the Southern Pacific agreed to sell only when it had become convinced that the Central Pacific could not be retained, and on the assurance that the Attorney-General would bring pressure to bear upon the Union Pacific in order to compel that company to offer a satisfactory price.¹ There is some reason to believe that the Union Pacific was more eager to buy than the Southern Pacific was to sell. Whatever the preference of the parties, the result of the negotiations appears in the second unmerging plan, approved by Southern and Union Pacific directors on February 6, 1913. This plan had also the sanction of the Attorney-General.² The Union Pacific now proposed to sell the

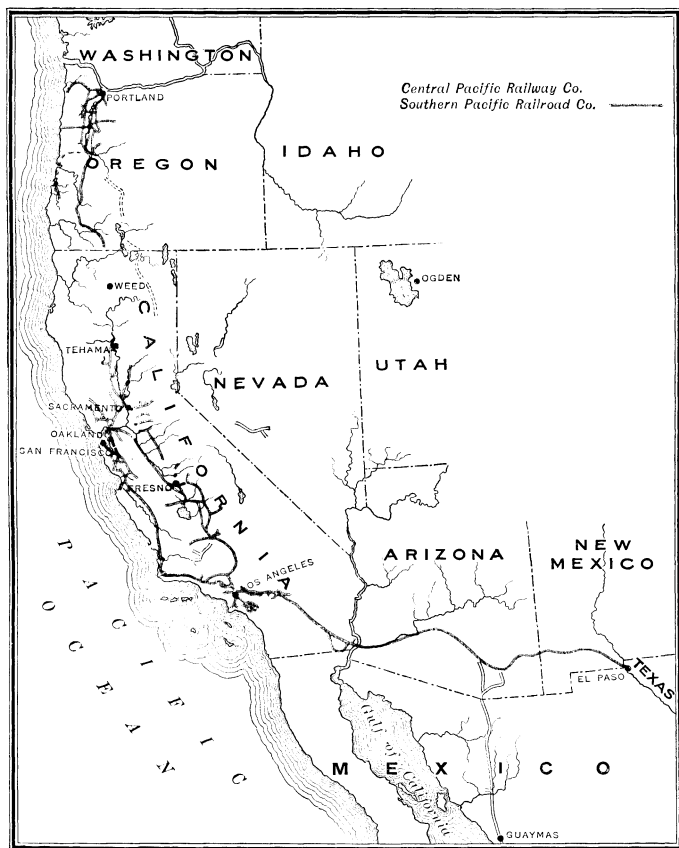
Transcript of Testimony in Application 409 before the State Railroad Commission of California, pp. 158-159, Sproule, referred to hereafter as "Transcript of Testimony." See also a statement by the Attorney-General in *New York Journal of Commerce*, December 19, 1912.

¹ Transcript of Testimony, pp. 162-164, 195, Sproule; pp. 32-33, Lovett.

² *New York Journal of Commerce*, February 10, 1913.

1,266,500 shares of Southern Pacific stock in the treasury of the Oregon Short Line to stockholders both of the Southern Pacific and of the Union Pacific Companies. With the proceeds of \$84,675,500 of this stock, less commissions and syndicate expenses, together with \$14,065,441 in cash and \$5,449,000 in Southern Pacific bonds, it offered to buy the 672,755 shares of Central Pacific common and the 174,000 shares of Central Pacific preferred owned by the Southern Pacific Company. The price suggested was therefore in the neighborhood of \$104,000,000, which was approximately the cost at which the stock stood upon the Southern Pacific books. Judge Lovett has said that he never expected to give so much,¹ and in fact a price equivalent to \$123 a share seems liberal in view of the quotations of other six per cent stocks at the time. The responsibility for the Central Pacific funded debt of approximately \$200,000,000 was assumed by the Union Pacific. This occasioned no disturbance of outstanding securities, except in the case of the Central Pacific four per cent, 35-year European loan of 1911. Unfortunately, however, certain clauses in the indenture covering this issue caused a good deal of trouble. The loan was for 250,000,000 francs, and had been floated in France in March, 1911. It was guaranteed by the Southern Pacific and was secured further by collateral. In order to protect their clients the French bankers who handled the issue had

¹ According to Judge Lovett the Central Pacific was not likely to be as valuable to the Union Pacific as it had been to the Southern Pacific because the latter company would divert traffic to the Sunset Route. (Transcript of Testimony, pp. 50-52, Lovett.) Only the grant of certain preferential rights in California and the fact that the Southern Pacific stock owned by the Union Pacific was tied up pending settlement induced him to consent. (Transcript of Testimony, p. 62, Lovett.) Mr. Schlacks, Vice-President of the Western Pacific, on the other hand, thought the Central Pacific a bargain at \$104,000,000. He asserted that this sum, after adding outstanding bonds and deducting treasury assets, yielded a price of about \$100,000 per mile, which was about what the Western Pacific had cost to date. The Central Pacific, however, had larger facilities than the Western Pacific, better equipment, and a more fully developed territory. (Transcript of Testimony, pp. 317-318, Schlacks.)



stipulated that the Southern Pacific should not sell or pledge its holdings of stock in certain specified subsidiary companies, including the Central Pacific, during the life of the bonds, nor lease, sell or merge the properties named without their consent. Just one alternative was given: namely, that if the consent of the bankers was asked and refused, the Southern Pacific might after forty days declare the entire issue due and payable at the next interest date.¹ When the Southern Pacific decided to sell the Central Pacific it found these clauses in the way. An issue of refunding bonds could not have been sold early in 1913 except at a heavy discount. In an attempt to secure the French bankers' consent to the separation of the Southern and the Central Pacific, the Union Pacific offered to give its own guarantee for the security of the European loan and to substitute Union Pacific for Southern Pacific collateral. When this proved insufficient, it proposed a lease of the Central Pacific to the Union Pacific, and for these reasons such a lease became a feature of the second unmerging plan.²

It was originally intended to pay for the Central Pacific stock by transferring to the Southern Pacific \$84,675,500 of Southern Pacific stock held by the Union Pacific, along with the cash and bonds previously referred to. But the fact that the Southern Pacific was not permitted to purchase its own stock under its charter, nor reduce its capital except in the manner prescribed by Kentucky statutes, made the exchange impossible.³ The price at which the Southern Pacific stock was offered to stockholders was 98.67 plus accrued dividends, and the sale was underwritten at the same price by a syndicate

¹ Article III, Sect. 3 of the indenture dated March 1, 1911.

² Transcript of Testimony, pp. 28-31, Lovett.

³ *Ibid.*, p. 11, Lovett.

managed by Kühn, Loeb & Co.¹ An essential feature of this plan was the grant of superior subscription rights to Southern Pacific stockholders. That is to say, the holder of every four shares of stock of the Union Pacific was given the right to subscribe for one Southern Pacific share, but the holder of every three shares of Southern Pacific stock was to have the right to subscribe for a similar amount. The preference thus accorded Southern Pacific stockholders was deliberately intended to diminish the influence of the Union Pacific in the Southern Pacific, by giving shareholders of the former a smaller holding of Southern Pacific stock than they would normally have acquired. On the assumption that all stockholders availed themselves of their subscription rights the stockholders of the Southern Pacific would have owned 71 per cent of its capital stock after the unmerging was completed, while those of the Union Pacific would have held only 29 per cent.

It was realized at once by those familiar with conditions in the West that the proposed separation of the Central Pacific from the Southern Pacific raised problems of unusual complexity. The two systems have been treated as a unit since very early days. They were originally financed by the same parties, have been operated as a unit in the same interest, have used the same equipment, and have drawn on the same funds for extensions and improvements. The accompanying map will show how hopelessly intertwined their mileage has become. The Central Pacific in all the years since it was first built has never entered San Francisco over its own rails, nor reached any port along the Pacific Coast such as San Diego, San Pedro, Santa Barbara, Monterey, or Santa Cruz. It does not even possess the short line from Sacramento to Oakland, but controls only a

¹ Cf. Transcript of Testimony, p. 105, Lovett.

round-about route via Tracy and Niles. On the other hand, the Oregon lines are dependent upon the Central Pacific for connection with the Southern Pacific in California, and a quantity of Southern Pacific branches such as those from Raymond to Berenda, and Lodi to Valley Springs, are totally separate from the company which built them.

The situation at the Oakland terminal is especially complicated. The ferry-boats which connect San Francisco with the western end of the main transcontinental line at Oakland are owned by the Central Pacific Railway. The pier at which these boats dock is held by the Southern Pacific Company under a fifty year lease from the City of Oakland that expires in 1960. The steam railroad tracks upon the pier are owned by the Central Pacific Railway. For a space of something over 1300 feet east from the line of low tide these Central Pacific tracks pass over land owned in fee simple by the Southern Pacific Company, to arrive at property sold by the old Contract and Finance Company to the Central Pacific Railroad in 1872. Beyond this, trains are operated over land held by the Western Pacific Railroad Company under an easement which dates from 1870; and beyond this still comes land which the Western Pacific Railroad Company owns outright under deed of sale of 1874.¹ Until two or three years ago the railroad officials themselves were ignorant of the extent of the tangle to which long continued common management of the Southern Pacific and the Central Pacific had given rise.

In view of this mingling of ownership a certain number of mutual concessions formed a necessary part of the plan to separate the Southern and the Central Pacific companies. These may be listed as follows:

¹ The Western Pacific Railroad Company which built the original line from Sacramento to Oakland should not be confused with the Western Pacific Railway controlled by the Gould interests.

(1) The lease for 999 years by the Central Pacific of its line of railroad from Tehama, California, to the Oregon boundary, to the Southern Pacific Railroad Company at an annual rental of 5 per cent.

(2) The sale by the Central Pacific to the Southern Pacific Railroad Company of the line of railroad, now partly completed, from Weed, in Siskiyou County, California, to Natron, Oregon.

(3) The lease for 999 years by the Southern Pacific and the Southern Pacific Railroad Company to the Central Pacific of its line of railroad from Sacramento by way of Benicia to Oakland at an annual rental of $2\frac{1}{2}$ per cent. This lease was to give to the lessee an equal joint use with the Southern Pacific Company and no other line was to be admitted to joint use without the permission of the Central Pacific.

(4) The lease for 999 years by the Southern Pacific and Central Pacific to one another of the joint use of their respective terminals, including industry tracks, at all junctions of their respective lines within city limits.

(5) The lease for 999 years by the Southern Pacific Railroad Company and the Southern Pacific to the Central Pacific of trackage and running rights over the lines of the former companies between Redwood City and San Francisco, for through freight trains only, at an annual rental of 5 per cent.¹

In addition the leases of the Central Pacific and allied lines held by the Southern Pacific were cancelled as a matter of course.

Under these arrangements the plan was not impracticable. The whole scheme, however, had to face determined opposition on the Pacific Coast.² This was based on the following considerations.

¹ In the matter of the Application of Central Pacific Railway Company et al. Decision No. 477. Railroad Commission of California, p. 6.

² See, for example, the San Francisco Chronicle of February 6, 1914.

In the first place, it was alleged that the breaking up of one system into two would impair service and increase rates on local business. This traffic is heavy. It includes shipments of fruit from orchards to canneries, oil from the interior and coal from the seaports to consuming points all over the state, lumber from Northern California and Oregon to the south, dairy products from the country to the cities, and merchandise in the contrary direction. It is observed by shippers that freight moving from a station on one system to a station on another already takes materially longer than freight sent an equal distance over one line. Similar differences exist in passenger service. The rate expert for the State Railroad Commission has pointed out that trains to Bakersfield which move through Tracy, Lathrop, Modesto, Merced, Fresno and Goshen, using the Central Pacific to Goshen and the Southern Pacific beyond that town, would be sent through Tracy, Kerman, Fresno, and Exeter, or through Tracy, Kerman, and Goshen, if restricted to the use of Southern Pacific tracks alone.¹ The particular example is badly chosen, in that the short line mileage from Tracy to Bakersfield over the Southern Pacific is only six miles greater than the mileage of the combined Southern Pacific-Central Pacific route. Yet some disadvantages there may be. Even a cursory study of the location of the Harriman lines in California shows that Central Pacific points on the east side of the San Joaquin valley are likely to find their connection with San Francisco impaired by a division of the system into two parts, and that Southern Pacific points such as Armona or Kerman will be unable to reach Santa Cruz or Monterey as easily as before. Nor can there be any assurance that service which is more expensive to render will not be

¹ Transcript of Testimony, pp. 425-426, Sanborn.

sold at a higher price. Mr. Sproule, indeed, pledged his company to oppose an increase in charge due to conditions arising out of the separation of the Southern Pacific and the Central Pacific;¹ but such a pledge is unsatisfactory security when greater costs are constantly tending to produce higher rates.

Many people also believed that the separation of the Southern Pacific and the Central Pacific would not increase competition on interstate business to any noticeable extent. It was the opinion of the State Railroad Commission that the Southern Pacific would be so weakened by the loss of its feeders in Central California and by the passing of the line from Oakland to Ogden from its control that it would be unable to meet the Central Pacific north of the Tehachapi on equal terms.² Doubtless the chief consideration here was the fruit traffic. Most of the oranges from points north of Fresno now move via Ogden and will continue to do so. The same is true of the deciduous and citrus fruit from Northern California. Mr. Sanborn of the Commission's staff has testified that most of the fruit, deciduous and citrus, originating north of the Tehachapi, would use the Central Pacific rather than the Southern Pacific if the present combination were broken up.³ The Southern Pacific would suffer from the loss of this profitable traffic, and would be subject, in addition, to peculiarly severe competition from the Panama Canal on the business that was left. Certain clauses in the mutual concessions of the Central Pacific and the South-

¹ Transcript of Testimony, pp. 152-156, Sproule.

² "The Central Pacific would have a line," the Commission said, "into all the points south of Tehama of importance except perhaps Woodland, and as far down the state as Goshen. It would come into San Francisco over the Benicia route and would be able to go in by way of the narrow gauge line and the broad gauge line from Owenyo to Mojave covering about all the territory in the state." Transcript of Testimony, p. 36, Eshleman.

³ Transcript of Testimony, pp. 422-423, Sanborn.

ern Pacific seemed also likely to hinder competition on interstate business. This was particularly true of the lease by the Central Pacific and the Southern Pacific to one another of the use of their respective terminals, including industry tracks within city limits, and the granting of traffic rights to the Central Pacific over the Benicia line from Sacramento to Oakland. A well informed railroad man has estimated that seventy-five per cent of the business of a city like San Francisco is handled to and from industry tracks or team tracks, and only twenty-five per cent to and from the freight houses. As a long-established road, the Southern Pacific possesses valuable terminals in and about San Francisco, Oakland, San José, Fresno, Stockton, Sacramento, Marysville, and many other smaller places. It follows that so long as the Central Pacific, alone among transcontinental roads, has access to these properties, no new road entering California is likely to do much business.

A few illustrations will show the difficulties which a competing company, the Western Pacific, has already had to face. The Southern Pacific accepts cars which come in over the Western Pacific for delivery at Southern Pacific industry tracks in San Francisco, but demands $7\frac{1}{2}$ per cent of the Missouri river rate, amounting to 15 per cent of Western Pacific earnings on traffic from the Missouri river, as compensation merely for its switching service. When the traffic originates at competitive points west of Colorado common points the switching charge becomes \$7.50 per car. Thus a car switched from an industry on a Southern Pacific industry track at Stockton and transported by the Western Pacific for delivery to an industry on Southern Pacific tracks at San Francisco pays \$7.50 at each end, or a total of \$15.00, which is as much as the carload rate from San Francisco to

Stockton on some classes of business. Nor is the switching charge the only difficulty. On traffic from Colorado, Kansas, Nebraska, Texas, and Missouri River Territory, which is delivered to the Southern Pacific by the Western Pacific at interchange points and which is destined to stations not served by the Western Pacific, the Southern Pacific exacts 23 per cent of the terminal rate as a division, plus any local arbitrary or rate added to the terminal rate in computing the charge to destination. On traffic from towns east of the Missouri River the 23 per cent applies to the earnings west of the river.¹ Vice-President Schlacks of the Western Pacific has testified that the Western Pacific has to pay the Southern Pacific 50 per cent of the terminal rate plus local charges in some cases in order to secure delivery at destination of freight which the Western Pacific has brought to California.¹ It is an interesting fact that the Western Pacific received only 54.3 per cent of the revenue west of Salt Lake City during the six months ending in October, 1911, on business interchanged with the Southern Pacific, altho it did 91.8 per cent of the hauling.² Shippers at San Francisco hope that eventually the Chicago and Northwestern, the Burlington, the Rock Island, and other roads as well as the Western Pacific will build through to the coast.³ A far-sighted policy will hold the way open to them. Very much the same objections apply to exclusive use by one or two railroads of the Benicia cut-off, that have force when

¹ Memorandum of Interchange Arrangements between the Southern Pacific Company and the Western Pacific Railway Company. Application 409, Railroad Commission of California, Western Pacific Exhibit No. 1.

² Transcript of Testimony, p. 295, Schlacks.

³ Application 409, *supra cit.* Western Pacific Exhibit No. 4. When the Harriman interests prepared the second unmerging plan they thought it wise to provide explicitly that existing divisions should not be regarded as precedents or otherwise taken into account in the adjustment of new divisions between the Central and the Southern Pacific. Transcript of Testimony, p. 54, Lovett.

Wheeler, Wm. R. Transcript of Testimony, pp. 405-406.

free access to San Francisco industry tracks is under discussion. The cut-off is a short line between Sacramento and Oakland which has reduced the distance between the cities 40 miles, and the time for passenger trains about two hours. It is not used for freight, but it affords a conclusive advantage on passenger business over the round-about routes of the Western Pacific or of the Central Pacific via Niles and Tracy. Undoubtedly the Southern Pacific could not be required to open its terminals or its Benicia line to any other road except of its own free will, but there are definite grounds of public policy for insisting that it give the same facilities to all that it accords to any connection.¹

Besides these two main objections there were certain characteristic charges made. It was maintained by the *San Francisco Chronicle* that the dissolution plan in its entirety was a device to rob the Southern Pacific for the benefit of the Union Pacific, which was directed by leading interests in the latter company and was carried out by means of dummy directors who at no time had the interest of the Southern Pacific at heart. This charge would have been plausible had the original directors elected by the Union Pacific remained on the Southern Pacific board while negotiations were going on, but it has little probability in view of the fact that the directors of the Southern Pacific who were also directors of the Union Pacific resigned in January, 1912; that the successors of these gentlemen were approved by the Attorney-General; and that the shares owned by the Union Pacific were not voted in the next annual election. It appears, also, that a protective stockholders' committee representing independent stockholders was formed in New York immediately after the first decision

¹ The approval of the Attorney-General to the second unmerging plan did not include an approval of the provisions relating to industry tracks and to the Benicia Short Line. He did not consider these matters. Transcript of Testimony, pp. 5-6, Lovett.

of the Supreme Court. This committee took part in all subsequent proceedings and approved the plan of reorganization finally selected.¹ Another insinuation with probably as little foundation was that the Kühn Loeb & Co. syndicate had moulded the terms of the unmerging plan so as to make Southern Pacific stock an undesirable investment, in order that stockholders of the Southern Pacific Company might be deterred from buying, and that the syndicate dominated by Union Pacific interests might secure control; thus perpetuating an arrangement which the Supreme Court had condemned. The amounts involved, the widely extended membership of the syndicate,² and the fact that the price of Southern Pacific stock did not advance after the failure of the second unmerging plan are evidence against the truth of this statement.

The conviction that for these various reasons a separation of the Central Pacific and the Southern Pacific would work injury to the Pacific Coast aroused public sentiment in that section to an unusual degree. As it happened, the consent of the State Railroad Commission of California was necessary to the execution of the leases and sales in California which formed an integral part of the dissolution plan. Application was made to this Commission in March with a result which might have been expected.³ The Commission heard testi-

¹ Transcript of Testimony, p. 192, Herrin. See also a letter by Mr. Kruttschnitt, reprinted by the New York Journal of Commerce, January 13, 1914.

² About \$40,000,000 was placed in Europe. Transcript of Testimony, p. 65, Lovett.

³ Judge Lovett insisted at this time that the California Commission must approve the plan in its entirety or not all. The following question and answer passed between the Judge and President Eshleman:

Commissioner Eshleman: Your position, then, Judge Lovett, is that any conditions that might be imposed which would either add to the burdens of the Union Pacific or take from the burdens of the Southern Pacific, or any conditions whatever which were not exactly in accord with this contract, would bring about the defeat of the project as it is now presented?

A. Yes, Mr. Chairman.

Transcript of Testimony, pp. 111-112, Lovett.

mony for three days, and then refused its approval. Its main opposition ran to the lease of the Benicia Short Line and the joint use of terminals including industry tracks. It also opposed the 999 year term of certain leases, and insisted that the rentals in all cases should be subject to its approval as to their amount. In general the Commission was opposed to the sale of the Central Pacific local lines to the Union Pacific, and suggested as an alternative a sale or long time lease embracing only the line of the Central Pacific from Ogden to Sacramento, with trackage rights from Sacramento to Bay points; but it recognized that this feature of the agreement was not subject to its control. A supplemental opinion indicated in some detail the arrangements which the Commission would approve.

This adverse report was rendered on February 24, 1913. The syndicate agreement to underwrite Southern Pacific stock expired on March 15th. In the attempt to avoid the loss of \$1,266,500 in commissions the railroad interests agreed promptly to modify their plan,¹ and to propose a sale and lease of the Central Pacific to the Union Pacific without provision for the joint use of the Benicia line, the joint use of terminals, and the trackage and running rights from Newark to Redwood, and from Redwood to San Francisco. Judge Lovett wired the new suggestions to his attorneys at San Francisco on March 12th for submission to the California Railroad Commission. He declared that the Commis-

¹ The commissions to the underwriting syndicate had been set at two per cent of the entire \$126,650,000 besides expenses if the plan went through, in addition to which Kühn Loeb & Co. were to receive a compensation of one per cent of the same amount for their services. If the plan should fail the syndicate was to receive $\frac{2}{3}$ of one per cent and Kühn Loeb and Co. $\frac{1}{3}$ of one per cent besides expenses. It was stipulated that expenses should not exceed $\frac{1}{4}$ of one per cent.

See Syndicate Agreement of February 10, 1913, and accompanying correspondence, Application 409, Applicant's Exhibit No. 1. This commission was to be paid by the Union Pacific and the Southern Pacific respectively on the basis of shares to be distributed to their stockholders. Transcript of Testimony, p. 201, Sproule.

sion might approve the minor leases and sales subject to its reserved power to revise the valuations, but that the approval of the lease of the Central Pacific to the Union Pacific must be given immediately and unconditionally, or the necessary proceedings could not be held before the Circuit Court at St. Louis soon enough to prevent the expiration of the underwriting syndicate, and the failure of the entire plan.¹ There seemed reason to believe that certain traffic agreements between the Central Pacific and the Southern Pacific formed part of the modified arrangement. Certainly Judge Lovett had stated that the price of 104 million dollars for the Central Pacific included a payment for exclusive privileges at San Francisco. If such rights did not appear in the agreement it was natural to suspect that they were provided for outside, and this later proved to be the case. Influenced by a suspicion of this kind, the Commission refused again to consent to the plan proposed. "It is not our disposition," it said, in a long telegram to the Attorney-General, under date of March 14th, "to stand in the way of the substitution of the Union Pacific for the Central Pacific in the control of the property of the Central Pacific in the event the Union Pacific is permitted to secure all the stock of the Central Pacific . . . but there is certainly no reason why the Union Pacific, through the Central Pacific at Sacramento, should be regarded by the Southern Pacific as a preferred connection as regards the short line of the Southern Pacific by way of Benicia to Oakland. . . . According to the only information we have, gleaned from the press, the Union Pacific is to pay the same amount for the property as was contemplated in the original plan. If this be true, . . . we are certainly justified in the assumption . . . that the Union Pacific

¹ Transcript of Testimony, p. 521, Cotton.

at least thinks it is getting the same thing by this alternative method which the Commission prevented it from getting by the former method."

With a laudable perseverance Judge Lovett and his associates now took up the task of preparing a third plan. They first secured an extension of time from the Supreme Court from May 12 to July 1, 1913. They then abandoned negotiations for the control of the Central Pacific and concentrated their energies on the disposition of the Southern Pacific stock without reference to the Central Pacific. It is true that the attitude of Mr. McReynolds, now Attorney-General in place of Mr. Wickersham, led to resumption of attempts to include the Central Pacific in the plan, but these proved fruitless and were finally abandoned. It is apparent that the conditions which the new scheme had to meet were simpler than those which had confronted the old, and the managers doubtless considered it no small gain to be able to disregard the California Railroad Commission. Under these favorable conditions the plan progressed rapidly to its final form in May. In its essential features it may be described as follows. First, and most important, the Union Pacific disposed of all its Southern Pacific stock. Of its total holdings, \$38,292,400 went to the Pennsylvania Railroad Company in exchange for \$42,547,200 of Baltimore and Ohio stock, or all the Baltimore and Ohio stock owned by the Pennsylvania or any of its subsidiaries. Southern Pacific stock exchanged for Baltimore and Ohio common at par, and for preferred in the proportion of 100 to 80. The remaining Union Pacific holdings of Southern Pacific stock, amounting to \$88,357,600, were to be sold to the general public through the Central Trust Company of New York. The Union Pacific Company offered to all stockholders of the Union Pacific and of

the Oregon Short Line common and preferred, the right to subscribe at the price of 88 plus accrued dividends, for certificates of interest representing Southern Pacific shares transferred to the Central Trust Company to the extent of 27 per cent of their holdings. Holders of these certificates of interest were to have the right prior to January 1, 1916, to present the same and to receive the number of shares of Southern Pacific stock represented by the certificates together with all dividends declared thereon, on condition that the holder make affidavit that he did not own in his own right any shares of the stock of the Union Pacific Railroad, that he was making the application in good faith in his own right, and was not acting for or on behalf of any stockholder of the Union Pacific Company or in accord with any agreement or understanding with any one seeking to control the Southern Pacific Company in the interest of the Union Pacific. Stock remaining in the hands of the Trust Company after January 1, 1916, might be sold by the trustee at the discretion of the court, and the proceeds distributed to lawful holders, that is, to the owners of certificates of interest who had been stockholders of the Union Pacific or Oregon Short Line at the time of subscription and had not divested themselves subsequently of their Union Pacific or Short Line stock.¹

The Attorney-General of the United States was of the opinion that the sale of the Southern Pacific stock to the Pennsylvania Railroad in this way would be a substantial step in the dissolution of the Union Pacific-Southern Pacific merger, and that it would at the same time have the desirable result of divesting the Pennsylvania Railroad Company of the capital stock of an active competi-

¹ *Commercial and Financial Chronicle*, vol. 97, pp. 50-51, July 5, 1913; p. 177, July 19, 1913; pp. 445-446, August 16, 1913; vol. 98, pp. 156-157, January 10, 1914.

tor, the Baltimore and Ohio. He had no objection to the trusteeship and sale of the remaining holdings of the Southern Pacific stock which were not turned over to the Pennsylvania, and said that the provisions respecting it were apparently well designed. He suggested, without insisting, that a proviso should be inserted leaving unobstructed the power of Congress to legislate respecting the stock or transactions in question in order to leave the way open in the event that a future Congress might desire to forbid another railway company to own stock in another non-competitive line. The United States District Court for the District of Utah, consisting of Judges Sanborn, Hook, and Smith, also approved the plan upon June 30, 1913, and the decree was signed in the Federal Court at Salt Lake City the same week.

On August 14, 1913, Kühn, Loeb & Co., managers for the syndicate which was formed to underwrite the sale of the certificates of interest representing \$88,357,600 of Southern Pacific stock, announced that the total subscriptions received up to the closing of the books amounted to \$220,000,000 or more than $2\frac{1}{2}$ times the amount of the stock. Allotments were accordingly made on the basis of 40 per cent of the amount subscribed for.

The final step in the unmerging process was the distribution of Baltimore and Ohio stock in the course of 1914 among the stockholders of the Union Pacific.¹ The distribution was first announced on January 6, 1914. Each common stockholder of record March 2, 1914, was to receive \$12.00 par value of Baltimore and Ohio preferred, \$22.50 par value of Baltimore and Ohio common and \$3.00 cash, or a total of \$37.50, yielding an average dividend of \$2.01, on the assumption of a six per cent

¹ Commercial and Financial Chronicle, vol. 97, p. 1894.

return on the cash distributed, six per cent on Baltimore and Ohio common, and four per cent on the preferred. The total dividend on these terms would amount to about \$89,000,000, the greater part of which represented a profit which the Union Pacific had secured from its investment in Southern Pacific, Great Northern, and Northern Pacific shares.

Three reasons were given in explanation of the transaction: (1) The dividend would meet the expectations of the common shareholders; (2) The Union Pacific would avoid criticism for holding stock in competing lines, a criticism which might be based on the \$17,857,-100 of New York Central stock which still rested in its treasury; (3) A reduction in the annual dividend rate from ten to eight per cent would be made possible, ten per cent being considered an undesirably high rate in view of the attitude of railroad commissions and state legislatures. Suit was brought by the Equitable Life Assurance Company to compel the Union Pacific to include the preferred stockholders in the distribution, but in vain.¹ The Supreme Court of the State of New York held that the preferred stock was entitled to no other share of the profits than dividends each and every year not exceeding four per cent. An accumulated surplus was regarded as divisible profit. It is expected that the matter will be carried to the Supreme Court of the United States. Protests were received from foreign holders of the Union Pacific convertible bonds, but without effect.²

As a result of the prolonged negotiations thus far described the government has obtained an unusually complete unmerging of a complicated combination. Not only are the Union Pacific and Southern Pacific

¹ New York Journal of Commerce, February 7, March 7, 20 and April 3, 1914.

² Ibid., March 14, 1914.

railroads separated, but none of the 1,265,000 shares on which control depended remains in the hands of stockholders of the controlling company. Some stockholders there are doubtless who own shares in both corporations, and the number may increase in later years, but the possibility of subsequent purchase by individual stockholders exists in the case of any company, and at least is not made more easy by anything in the process of dissolution of the Harriman lines. From the unmerging two things are gained.

In the first place, the financial power of the Harriman system is reduced. Too little emphasis is ordinarily laid on this matter in current discussions. An aggregation of companies operating 17,000 miles of railroad, and earning \$217,000,000 in a single year under the management of one group of men, has power that no government can control. The government can prevent excessive dividends, but it cannot eliminate indirect profits nor can it put a stop to abuses of authority not intended to result in financial gain.

Another advantage is that competition will be promoted. A statement of Mr. William R. Wheeler, Traffic Manager of the San Francisco Chamber of Commerce, describes so clearly the nature and importance of the sort of competition which the Pacific Coast is likely to enjoy, that it deserves citation.

"It is a popular fallacy, I think," said Mr. Wheeler, "that because there is not a rate war . . . following the advent of a new road into a territory, that, therefore, there is no competition. There is competition in the service and that is what we desire. There is also competition in this respect, that if you have two roads who have a voice in the rate question, you stand double the chance of gaining tariff concessions that you do if there is only one road to deal with; if there are three roads,

you stand three times the chance of getting your concessions; in other words, you do not find — are not as apt to find three men of one mind as you are two men of one mind and so on as the number grows. We already have had an example of that here in San Francisco: there was a proposition something more than a year ago to advance rates between San Francisco and Stockton . . . and the fact that it required the consent of three roads instead of two was the only thing that prevented that advance going into effect at that time; we were successful in convincing one of the roads that it was unfair to us to raise those rates and they declined to join in the advance.”¹

It should be added that the Southern Pacific does not share the view that it will be so weakened by the loss of the Central Pacific as to be unable to compete effectively with the Ogden route or with the Panama Canal. On the contrary, it is of the opinion that after the two companies are separated, if they are separated, the Central Pacific will lose business, and the Southern Pacific will gain it. This is not merely because of the advantage of continuous attention and responsibility which the El Paso lines will offer, but also because the southern route has worked in harmony with the route via Ogden in the past, while in the future it will work against it.² Moreover, in the past the Southern Pacific has refrained from lowering transcontinental rates in competition with the water lines because of the effect that this might produce on rates from intermediate points on the Union Pacific or from points east of Omaha in the Mississippi Valley in the business of which the Union Pacific was interested.³ The Southern Pacific operates a boat line from New York to Galveston, and its earnings from inter-

¹ Transcript of Testimony, pp. 408–409, Wm. R. Wheeler.

² Ibid., pp. 174–175, Sproule.

³ Ibid., pp. 147–148, Sproule.

mediate points are unimportant;¹ so that it is already considering the advisability of more vigorous efforts to tempt traffic from water routes to rail.

The Pacific Coast seems at first sight to have scored a distinct triumph, in that the Central Pacific and the Southern Pacific remain together as conditions are today. But this circumstance is likely to be only temporary. Attorney-General McReynolds shares fully the opinion of his predecessor, Mr. Wickersham, that the continued union of the two roads is a violation of the Sherman law, and on February 11, 1914, he filed a suit at Salt Lake City attacking the combination as one in restraint of trade.² There is every reason to believe that he will win his case. Yet even if he does, California at least may come out better than she expects and gain distinct advantages from dissolution in the long run.

In raising opposition to the separation of the Central Pacific and the Southern Pacific, shippers in California so far have forgotten that the Union Pacific will route more or less business via Portland over the Oregon Short Line so long as the Central Pacific and the Southern Pacific remain under common control. Business destined to California may never move this way but export business to the Orient very likely will. The distance is greater, but the grades are not more formidable, and the large future possibilities of the Oriental market make this consideration of importance to San Francisco. Even if the Central Pacific becomes independent, there will doubtless still be some tendency to send freight to the north, altho the Central Pacific as an independent road, relying for its existence on through business from California to the east, will be far more likely to fight for its

¹ Transcript of Testimony, pp. 175-176, Sproule.

² Railway Record, February 14, 1914.

share of the traffic by Ogden, than it will be when controlled by a system whose main interest lies in procuring a long haul further south. Under Union Pacific control, the Union Pacific will have every interest in promoting the trade of San Francisco.

What California and San Francisco both need for their own selfish interests is a direct connection with the east worked to its full capacity, and this they now seem likely to secure. Surely such a consideration may compensate shippers for some difficulties in respect to local business — difficulties which will probably prove less important than the exaggerated statements current on the Pacific Coast lead one to suppose.

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